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tricts have populations of between 367,000 and 382,000.

Commenting on this atrocity, the New York Times stated:

"The law is a blatant gerrymander, designed for one purpose only—to squeeze an additional Republican representative out of the city of New York in outrageous disregard of the proper standards for congressional districting."

Assemblyman Lewis Olliffe (Republican) in demanding later that the skulduggery be repeated in the districting for the State legislature, pointed out to his GOP colleagues that if it had not been for the above mentioned apportionment strategy of the Republicans in New York State, "the Congress would be Democratic today."

Olliffe was right. The GOP control in the House in the 83d Congress is the product of a gerrymandered majority.

As I stand here, I cannot help but feel that I am going to be the personification of an anticlimax.

After you have heard Congressman Judd and his brilliant eloquence, after you have heard the informative dissertation here by my friend, Mr. Lyons, and then in view of the fact that I don't have too much time available to me, I hope that I shan't strike that anticlimax too readily.

I do feel in a way as some of the students at Moscow University when they assembled one day and the professor at the university was talking about the interplanetary junketing that was possible in the near future. He said, "We will be able to travel to Mars, to Pluto, to Venus."

After his lecture, he turned to the student body and asked, "Are there any questions?"

At that time a student in the back of the lecture hall raised his hand and he said, "Professor, please tell me, when can we travel to Vienna?"

In this case, with the distance and mileage that I am to cover here, I hope that I will be able to do it in the time available.

One is very vulnerable when treating the many and numerous vulnerabilities that characterize the Communist empire. One could go ahead and enumerate, in a way Mr. Lyons has done, the various points of vulnerability on the sociologic, economic, religious, political, diplomatic, and numerous other spheres of this particular empire.

Another way, however, is to rank these points of vulnerability in some order of importance, seeking the main spots, or the crucial spots of vulnerability in this particular area.

As Mr. Lyons has pointed out, it will be my purpose to emphasize one area of vulnerability over others, not because I am at all attracted particularly to this point, but rather because I think that it is particularly relevant to any cold war activity that we might launch.

We should recognize that the future will not be one of any military foray or conflict with the Soviet Union only but rather will be, just as in past centuries—not to speak of the past decade—in the area of what we have called cold war activity. When looking over this past decade, one might be thinking of an article with the title "From Atomic Monopoly and Air Supremacy to Surrender Research." Rarely in the history of mankind has a country lost so much in so little a time than our own dear United States within this past decade.

This certainly is a source of great comfort to the people in Moscow and the Kremlin, and to their supporters. It can indicate to them that if they can realize their 7-year plan, if they can maintain and expand their military hardware, if they can for propaganda and other shows continue with their explorations into space, they are building up at the same time their instruments for cold war activity. They can expand their empire in this way whether it be in the Middle East, Asia, or elsewhere, and avoid any real global conflict.

For example: If in the event, let's say, of Iraq, because of internal Communist activities, supported to be sure by Moscow, there should be an overturn, ask yourselves what could the West really do? Would you say send SAC in there? Would you employ nuclear weapons? Aren't we neutralized by the special type of cold war activity that Moscow wages?

I would be the first to admit that this is an old technique. It is not the creation of Communists. It is a technique by which Russians were able to build up an empire, over the past, from Ivan the Terrible right down to the Russian Revolution. They have been able to use ambassadors; they used internal conflicts, as in the case of Poland, between classes, long before Marx; and they cer-

tainly employ these tactics to the greatest extent today.

If we should decide to engage them in this area, it won't be a matter of fighting on our side of the 50-yard line constantly, let them nibble away at us, and neutralize our armaments and instruments of military warfare; rather, we would have to seize some of their vulnerabilities and do it as cautiously, as skillfully as they have done and are doing in the area of the free world. In that case, we must study many of these vulnerabilities with great care.

One vulnerability, of course, is in the party itself. The party, as it exists today, appears to be completely Leninist in its form, in its rigidity, in its discipline. It continues to show the same strength that it had in the past. And it certainly is a medium for the advancement of the new class that definitely exists in the Soviet Union and the many new classes that are emerging in other areas of the empire.

I don't believe, however, that Mr. Khrushchev is fully entrenched to warrant any prime minister or any other person to say that his is the only voice. Surely he has made great progress in the past year and a half, and certainly since the 20th party congress; but to jump to the conclusion that, therefore, he has assumed a completely Stalinist position in the Soviet Union, I think, is unwise.

Now, looking at this area, what could be the point of vulnerability? To me it seems that this varies with time and circumstances. The Soviet Union was most vulnerable in this area upon the death of Stalin in March 1953. Those years were full of turbulence within many areas of the Soviet Union. The death of Stalin, followed by the liquidation of Beria, than the so-called triumvirate and up to the February 1956 congress, when you had a complete denigration of Stalin first by Mr. Mikoyan and then by Khrushchev; these were opportunities for the West.

They revealed a weakness, a weakness that came from a lapse in the succession process. There was a power conflict on the part of individuals and their supporters within this great party machine.

It contributed more than anything else to the numerical weakening of the Communist Parties in the West. Of course, we like to take credit for it, as for the decline of numbers in Italy and elsewhere at that time; but actually when many in these Western areas saw what was going on, and the contents of Mr. Khrushchev's speech were released, there began immediately a doubt, questions arose, and many actually deviated completely; a repetition pretty much of a situation in August of 1939.

Another point in connection with the party is the matter of the doctrinal revisionism. That surely is another vulnerable point. That, of course, takes into consideration the thing that we call Titoism. And the more you have of this revisionism, the greater the possibility for an undermining of the party position.

These are, to be sure, important points of vulnerability in connection with the party dictatorship. But it depends on time and circumstance.

If Mr. Khrushchev should die tomorrow or a week hence, there will be a problem. To what extent could we seize upon that, especially if we are so ill prepared as we indeed are today? But that is a thing nevertheless to be considered in any launching of a planned cold war activity which seeks a victory over time.

A second area that I would like to touch upon is sociological. Here we have a number of points which I shall consider very quickly. You have heard, of course, of the managerial discontent on the part of individuals who are connected with the various enterprises or trusts within the Soviet Union. They want

An Address on the Vulnerabilities of Russian Communism by Dr. Lev E. Dobriansky, Author of the Captive Nations Resolution

EXTENSION OF REMARKS

OF

HON. DANIEL J. FLOOD

OF PENNSYLVANIA

IN THE HOUSE OF REPRESENTATIVES

Monday, September 14, 1959

Mr. FLOOD. Mr. Speaker, while Mr. Khrushchev tours parts of this country, it would do well for the American people to give serious thought to the deep, underlying weaknesses of the Red czar's empire. Despite the bluff and bluster of Moscow's propaganda machine, Moscow fears any American exploitation of the opportunities presented by these real, inherent weaknesses.

This past summer Khrushchev himself displayed his fears with his crying pains over the Captive Nations Week Resolution. That resolution was originated and authored by Dr. Lev E. Dobriansky, a professor in Soviet economics at Georgetown University. Dr. Dobriansky is also the national chairman of the Ukrainian Congress Committee of America.

At the very time Khrushchev was blasting away against the resolution, its author was addressing the National Strategy Seminar held at the National War College here in Washington. The address, titled "The Political, Economic, and Social Vulnerabilities of Communism" depicts the areas of vulnerability in the Russian Communist empire and suggests certain practicable areas of approach for us.

Because of the pertinance of this address to American thinking about the aims and purposes of Khrushchev's visit here, I include the address in the RECORD.

TEXT OF REMARKS BY DR. LEV E. DOBRIANSKY, ON "THE POLITICAL, ECONOMIC AND SOCIAL VULNERABILITIES OF COMMUNISM," GIVEN ON JULY 22, 1959, AT THE NATIONAL STRATEGY SEMINAR HELD AT THE NATIONAL WAR COLLEGE, WASHINGTON, D.C.

General Armstrong, members of the faculty, and friends:

greater jurisdiction, more freedom in determining how to make goods, how to process them, and the like.

This is not a new thing. It has characterized the Soviet Union since the very first 5-year plan. And it was one of the factors pressing for the so-called economic decentralization that has taken place in the Soviet Union.

But all the evidence on this matter of economic decentralization affording greater latitude to these managers has shown, actually, that they continue to be almost as restricted as ever.

This, too, is a force. How crucial a force? To that question, I would answer not as crucial as many make it out to be.

Another force in the sociological area lies in the field of education. We have heard a great deal about this, and here is another example of cold-war accomplishment on the part of Moscow. After Sputnik, a year or so ago, we ourselves went into a rather excessive self-criticism of our own educational system and processes.

In this case the thinking goes, as they improve their education, more people are brought within that kind of training, which some consider to be superior to ours. In effect this reasoning, as Mr. Lyons time and time showed, really is doing the work of Moscow and is bringing about doubt and confusion in the United States. But the theory goes here that there will be a mellowing process, and through such education individuals, regardless of whether they are scientists, technicians, peasants, and the like, will begin to question, will begin to doubt. And, consequently, pressures will arise which will make the dictatorship in the Soviet Union more responsive to the needs of the people, make it less warlike, and in time that will be the basis for a blending, if you will, of their institutions with ours, and we get into the coming millenium.

The fact here is that, sure, education can be a liberalizing force, but the main point is education for what, and in what? It is certainly not a liberal education that we speak of. When one looks at the education, let's say in Nazi Germany, even in Japan, there was a great deal of education. You wouldn't say that Germany was below what the Soviet Union is at now. And yet that did not prove to be that instrument of evolution that many speak of today.

There is a high degree of naivete here; although one can recognize this as a source of trouble for the Kremlin, it is not crucial.

Let's look at other spheres; for instance, the religious. Well, many people who go to the Soviet Union report that there is a religious revival. But they may have seen the same churches twice. Oftentimes you find that one church seems to be filled to capacity simply because another church had been eliminated.

There is no concrete evidence of any vast religious revival within the Soviet Union. This, too, could be another force to be exploited, to be sure, but hardly a crucial one.

A fourth point would be, of course, with regard to the literati. I think Mr. Lyons handled that very effectively. The Pasternak case and numerous others, not only within Russia but within the non-Russian areas in the Soviet Union are of importance.

We had one, Bahriany, before the House Un-American Activities Committee.¹ He managed to escape from the Soviet Union after having played quite a role through his writings while he was in the Soviet Union pressing for human freedom and also national freedom. He himself is a Ukrainian.

Another area we want to look into is the economic. In this area, just as in the previous areas, a great deal of very questiona-

ble thinking is going on in many circles in the United States.

The main pressure here is, of course, for consumer goods. But this, too, is not a new pressure. This pressure has always existed since the centralization that took place from 1928 on.

Mr. Melenkov wrote it out in this decade, and Mr. Khrushchev to some extent is satisfying it. The 7-year plan, as you know, attempts to bring about an 80 percent increase in the industrial output by 1965 in the Soviet Union. But you notice that 0.9 of the new investment is going into the heavy and capital goods area.

In the area of housing, acute shortages exist. Despite the fact that Mr. Khrushchev attempts to increase that by one-third, the likelihood is, in view of the other considerations, that that will not be entirely fulfilled.

The same thing with real income. The plan contemplates an increase of about 40 percent in real income of the people in the Soviet Union. But what many don't recognize is that the realization of this 40 percent is entirely dependent, or to a great extent dependent, upon a concurrent increase of 70 percent in agricultural output.

That leads then into a great deal of problems; there is the matter of peasant resistance. Peasant resistance not along freedom lines as such, but to be able to get a better price for his product and at the same time to continue to have his garden unit and not be submerged in a larger collective such as Mr. Khrushchev contemplates, namely, the state farms.

The point here is that they, the Russian colonial planners, are confronted by many problems, and these problems in toto make up an economic vulnerability. Khrushchev has made a promise. Whether he will be able to realize that promise is a very crucial question that we shall have to follow and look at in the course of these years.

There was a great deal of propaganda at the launching of the sixth 5-year plan. As you know, within a year that had to be scrapped. And the 7-year plan, in a sense, is to take up what the sixth 5-year plan had contemplated.

The fact is that the Soviet Union is confronted—which Mr. Khrushchev himself admitted—by strained investible resources. It certainly will need a great deal of capital and more to be able to fulfill these goals.

In addition, in many areas resources are lacking, or at least the resources are being progressively depleted. There, of course, they might depend, as indeed they are, upon the minerals from China and also from some parts of central Europe.

Whether they can purchase these depends upon heightened productivity. Whether they will be able to achieve that is a question to be looked at.

So this is an important area, a vulnerability especially from a propaganda viewpoint; in whetting the appetite of the people in the Soviet Union for more and more consumer goods.

The next area is the political area. In the remaining time I should like to develop the matter of the non-Russian nations in this empire known as the U.S.S.R. I should like to dwell on the force of nationalism throughout the Soviet empire, and on the relation of Moscow, which is in Russia, not only to Warsaw, Budapest, but also, within the Soviet Union, to Kiev, Minsk, to Tashkent, and numerous other capitals in the non-Russian republics within the Soviet Union.

In doing so, I am not impervious to the contentions of others that there are freedom forces operative within Russia itself. On the contrary, many of the points brought out by Mr. Lyons are quite true. But oftentimes I feel that there is an unnecessary and perhaps a very misleading confusion,

when we do not use proper concepts in connection with the Soviet Union. And as a consequence, in having this confusion in any cold war activity we would not know what to feed one area of this empire and what to feed another area.

Let me give you a few illustrations of the confusion that arises even in the utterances of people in the highest places of our Government and in our own politics.

Mr. Acheson, for example—who has said better things, but I just wonder whether he understood what he said—in a recent talk at the Colgate Foreign Policy Conference at Colgate University last July, spoke on "A Critique of Current Foreign Policy." In it you come across this: "The Soviet Union is not only a vast and powerful nation * * *." There is the rest of it, and end of quote.

To him the Soviet Union is a nation. The concept of nation, is it like ours? Is it really one with a spirituality that unites all the various people within our Nation? Well, it would seem so on the basis of this quote.

Mr. Herter, for example, appearing before the House Foreign Affairs Committee this year, in a section of his statement said, "The most immediate is the threat of Communist imperialism. The world's second most powerful nation, the Soviet Union," and he goes on.

Mr. Allen Dulles, another example of the confusion of terms, before the Edison Electric Institute last April likewise speaks of the Soviet Union as though it were a nation, as though you had a Soviet people, as though you had a common basis that would account for the behaviors not only of the Russians but of the Lithuanians, Latvians, Ukrainians, and numerous others within the Soviet Union.

I think this is highly suggestive. This isn't a matter of just flippant semantics, as some of us are prone to say; the fact is that not only do ideas have consequences, but words have consequences as well, in view of the fact that words usually are the eyes of one's ideas.

It seems to me that one, in treating the Soviet Union, must constantly bear in mind that you have a very important non-Russian periphery, running from the Baltic, and consisting, of course, of the three Baltic nations, the Estonian, Latvian, Lithuanian, then coming through Byelorussia, and Ukraine, and from the Ukraine into the very vital area of the Caucasus where you have distinct nations, the Georgians, Armenians, and the Azerbaidzhans.

Then in central Asia, at the moment, you have five republics. Anyone familiar with the history of the Soviet Union knows that Moscow is very anxious to divide this area permanently and actually broke what was Turkistan into five distinct republics.

Also, in the area of the so-called Soviet Far East, even in 1917 there were people, many of them Russian, who developed decentralist tendencies, and actually set up their own republic at that time, which lasted until about 1921-22.

Consequently, the Soviet Union, populationwise, resourcewise, and in many other areas, as I will indicate in a moment, is by no means a nation. The problems that confront the Russian people are not necessarily the same problems that are confronting the other peoples and nations with the Soviet Union.

Let us quickly take up population. The Soviet Union has released statistics of its population this past spring; it places it at 202 million. But the fact is that in considering this population figure, one has to do it in terms of what has taken place in the past, not only within the Soviet Union, not only before 1922-23, but even for that, going back into the history of the whole Russian empire.

These statistics have been played with. The statistical sampling procedure employed

¹ Ivan P. Bahriany, "Control of the Arts in the Communist Empire," consultation, June 3, 1959.

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was not of the sort that any Western statistician would accept.

Consequently, the conservative least one could say is that about one-half of the population of the Soviet Union is Russian; the other half is non-Russian. People like Lenin and numerous others, when it was worth their while, pointed out, prior to the Russian revolution, that over one-half or about 57 percent of the population in the Russian Empire was non-Russian.

This, however, takes only the Soviet Empire as a whole, but when one looks into the individual republics, it is significant that in many of these areas, which are national areas, there is a vast majority of non-Russians as against the Russian. Of course, Moscow doesn't release that kind of figures to show what the composition of the non-Russian population is, for example, in Ukraine or in Armenia, as against the Russian.

Another point to impress this perspective upon you is the matter of resources. If you were to look into the resources of the Soviet Union—we make a great deal of that—you will find that although the R.S.F.S.R. appears well endowed with resources, certainly to sustain even agriculturally the Russian people within the R.S.F.S.R.; yet in the Soviet Union the major resources are found in the non-Russian areas. Oil, for example, in the first Baku region is in a Moslem, non-Russian area; also the Fergana Valley, the second Baku, is again in the area of Turkistan.

The same is true for agriculture. The most important single agricultural base is Ukraine. Many minerals and other resources are found in the Caucasus and elsewhere.

In view of all this, one can't help but wonder what would Russia proper be if, at the time of the Russian revolution, the non-Russian revolutions for independence on the part of these many areas which are now within the Soviet Union had permanently succeeded.

There was a Russo-Georgian war that lasted into the year 1920-21. The Georgian people attempted to sustain and maintain their independence. They were even recognized by Moscow, not to speak of many Western powers. In varying degrees that was true of Ukraine. It was true of a number of other of these non-Russian republics. Without these, Russia itself would be reduced to a second-rate power.

This situation must constantly be kept in mind, this kind of division, this natural kind of nationalism.

I could go on for an hour to indicate to you from the 1920's right down to the present time the persistence, the sustained nature of the resistance, the pressures on the part of many of these non-Russian nations to gain greater autonomy, to gain greater independence, and eventually complete national freedom.

Just a few weeks ago you must have read—and I understand there is great validity to this—of the dispatch of the Red Army, presumably for maneuvers, into the Carpathian area, where there have been, down to the present day, political bases of the Ukrainian underground and even Slovakian units that have opposed the Kremlin and its secret forces.

Operating in this area does not mean that we are opposing the Russian people. On the contrary, I could cite many bits of evidence, especially in this decade, that Russians and non-Russians in slave labor camps and elsewhere are actually collaborating. These Russians, and these non-Russians, which Mr. Lyons and others would regard as extremists, understand respective national aspirations.

In conclusion, we might ask, of what importance is this force of nationalism, operative in the Soviet Union itself, to us if we

should launch cold war activity? The ramifications appear immense.

Look at it in terms of the party. There has been a rumor of late—and it is not the first time—that an attempt is being made to bring about the establishment of a Russian Communist Party instead of the present overall Communist Party of the Soviet Union. In that case, if you have that, and you have the Ukrainian Communist Party and others, again a feeling of independence would build up despite the fact that the Communist framework would remain. Some have even suggested the following in the U.N.: You have Byelorussia and Ukraine represented in the U.N. What is there to stop Mr. Lodge or someone else from saying, "You have these two republics. You don't need a Mr. Gromyko or any other representative for the Soviet Union as a whole. We want someone from the R.S.F.S.R. In other words, have a true bona fide Russian representative in the U.N."

Another point, going into the psychological field. Why do we restrict our publication of America just to the Russian language? Why isn't it possible to have America circulate in the Ukrainian language, in the Turkistanian language and numerous others, to indicate that we are not only concerned with the Russian people, seeking to gain their confidence and their loyalties, but that we are also concerned with these of the many non-Russian nations within the Soviet Union.

One need only look and read the constitution of the Soviet Union. It promises separate military units. Can you visualize what would happen if you had a separate Georgian Army, a separate Ukrainian Army, a separate Byelorussian Army?

In the case of Hungary, Moscow realized what would happen if you have a nationally compact unit. But that also suggests to us that the military forces of the Soviet Union are not monolithic.

It is not even nationally integrated. As a matter of fact, about 42 or 43 percent of the forces in the Soviet Union happen to be non-Russian. The policy pursued by Moscow is always to make sure that military personnel coming from a certain republic are not stationed in that republic.

Many Ukrainians will be found right above northern Korea. National forces are dispersed.

In conclusion, I don't know whether we have arrived at Vienna or not. But, as I said, it was a little trying, especially after this heavy barrage of informative and instructive talks that you had this morning. It is really a pleasure to be with you.

Tailoring Banks' Annual Reports for Both Depositors and Stockholders—Part I

EXTENSION OF REMARKS

OF

HON. ABRAHAM J. MULTER

OF NEW YORK

IN THE HOUSE OF REPRESENTATIVES

Tuesday, September 8, 1959

Mr. MULTER. Mr. Speaker, on January 7, 1959, I introduced my bill, H.R. 1035, to protect the integrity and independence of national banks. My bill would strengthen the laws relating to ownership of stock in such banks.

In this connection, I commend to the attention of our colleagues the following articles which appeared in the publication *Banking*, April and May, 1959 issues. These articles were written by Henry P.

Hill, a partner in the accounting firm of Price Waterhouse & Co.

He is an alumnus of Brown University and of the University of Pennsylvania. He is a certified public accountant in several States and a member of the American Institute of Accountants and the New York State Society of Certified Public Accountants. In the former organization he is a member of the special committee recently appointed to study the question of statistical sampling in auditing. In the New York State Society of CPA's he is a member of the committee on cooperation with bankers. In the past year or two he has addressed the eastern regional convention of the National Association of Bank Auditors and Comp-trollers and various local meetings in the same field. He has written articles for several publications and at present is a member of the editorial board of the "What To Read" department of the *Journal of Accountancy*.

The articles follow:

TAILORING BANK'S ANNUAL REPORTS

(By Henry P. Hill)

Something is wrong with published financial statements of banks. This is a recurring theme in the writing of both accountants and bankers. In late 1957, for example, the accounting profession, through its magazine, was addressed by a bank president on the failure of banks as an industry to adopt uniform accounting principles in their financial reports to the public. In September 1958 a special committee of the Connecticut Bankers Association issued a report entitled "Suggestions for Uniform Financial Reporting by Banks."

This preoccupation with lack of uniformity is not a new thing. In 1952 a committee of the National Federation of Financial Analysts Societies reviewed the annual reports of 28 of the largest banks in the country and reported that "the variations in content of the reports are so broad as to make one wonder how there could be so many varieties of reporting to stockholders."

In the face of this kind of criticism, banks in recent years, particularly the large publicly owned banks, have had considerable improvements in their annual reports. The improvements, however, seem to have been in the direction of more complete disclosure instead of toward more widely accepted accounting principles. From the standpoint of the owners of the banks the average report is still not good.

MOST COMMON CRITICISMS

What precisely are the criticisms usually made of the financial reporting of banks? Perhaps the most fundamental one is that the majority of banks do not clearly identify the amount of net income for the year. Many smaller banks, in fact, do not even include in their published figures a statement of earnings. Large or small, those that do publish such a statement often include entries in the undivided profits account which by their nature should be included in the determination of net income.

Second, banks often do not describe the basis on which assets are stated nor the amount and character of related reserves. In an industrial company, for example, it is considered important that the gross cost of the capital assets be shown and that the amount of depreciation taken so far be deducted from this figure to arrive at the net undepreciated amount carried forward to the next period. It is a rare bank, however, that shows in its financial statements anything except the net amount of the banking house and other capital assets.

Third, banks do not follow acceptable methods of depreciating capital assets to

charge the cost of these assets systematically to the operations of the periods covered by their useful lives. Instead, many banks have written off capital assets with an eye to the year's profits and have varied the writeoffs with the profits. In some cases these writeoffs have been charged to the undivided profits account, with the result that both the statement of condition and the statement of earnings are incorrect.

Fourth, bank accounting is characterized by an extreme conservatism. Every opportunity to write down assets is availed of, and, in addition, many reserves are provided that cannot be related to the assets. Unallocated reserves for security and loan losses are cases in point, as are the treatment of capital assets and security premiums and discounts mentioned elsewhere in this article.

Fifth, only in unusual cases is it possible to derive from a bank's annual report an analysis of the movement in the reserves during the period. Many times through these reserves it is possible to provide in good times for losses that may come in less favorable times. The losses, however, never appear in the earnings statement and thus escape the notice of the average reader, and the provisions being made out of undivided profits likewise never appear in the earnings statement.

Sixth, the determination of interest from and profits and losses on sales of investments in securities is unrealistic. Many times the earnings statement shows as interest earned the coupon rate of interest paid by the issuer rather than the interest earned by the bank on its investment. Since the price paid for the type of security generally held by banks is determined by the market rate of interest, and the coupon rate which was fixed when the securities were issued is merely one of the elements in determining this price, there is serious doubt that the resulting figures can have any use whatever to the person attempting to analyze the bank's income.

INTERESTS OF DIFFERENT PARTIES

The general tone of bank accounting seems to result from the history of banking in the United States, which years ago was punctuated with panics and bank failures. Even today in a sound bank the ratio of the bank's investment to depositors' funds is small, and in the more liberal climate of past decades it might have been even smaller. Banks' depositors were poorly protected and bank failures had social as well as economic effects upon a group of people who outnumbered by far the banks' owners.

It was, and is, socially desirable, therefore, that the accounting and reporting practices of banks be designed to inform and protect the depositors of the bank. In this respect, banks differ from industrial organizations, where the primary objective of the reporting is to apprise the owners regarding their financial condition and achievements. This social aspect of bank reporting has produced the kind of thinking characterized earlier as conservative. Actually, as accountants have said many times, what is conservative in one fiscal period will usually turn out to be overly liberal in a succeeding period. An unjustifiably high depreciation rate, for example, will understate income in the earlier years when the capital assets are being depreciated and will overstate the income when those assets become fully depreciated but are still in use. The result is that over a long period, instead of achieving conservatism, banks' statements of income have achieved a high degree of distortion.

It is not desirable, however, that the interest of the investors be overlooked. True, the depositors of the banks still outnumber the owners in number and in amount of investment, and their financial interest in the bank should be clearly stated. On the other hand, the owners of banks, particularly the larger publicly held banks in the

metropolitan centers, constitute an important and growing segment of the financial community. As the number of stockholders in these banks gets larger it becomes more and more important that shareholders' earnings and shareholders' equity be fairly reported. For example, there are reported to be at least 14 banks in the United States with more than 10,000 shareholders each.

THE ACCOUNTANT'S VIEW

Accountants, particularly professional accountants who may deal more with commercial and industrial organizations than with banks, are apt to overlook the fact that there are these two groups with an interest in the financial condition of a bank and that the interests of these two groups are not the same. Thus, professional accountants may attempt to apply commercial and industrial rules to bank accounting. Bankers, on the other hand, having been schooled in the requirements and conservative thinking of the regulatory authorities, conditioned by years of experience with the present form of bank reporting, and desirous of eliminating differences between book and tax income because of the special rules of the Internal Revenue Code, are inclined to reject the views of the professional accountants as being primarily designed for someone else. They disregard the fact that the principles of income determination advocated by the accountants have been found quite useful in the financial statements of the banks' own borrowers.

A PROPOSED SOLUTION

Actually, it should be possible to devise financial statements that will be useful and informative both to the depositors and their watchdogs and to the shareholders. Such financial statements should clearly indicate the assets available for the protection of the depositors and should state these assets at current realizable values. "Current realizable values," in this sense, means that market values of all assets having a ready market should be disclosed. While it has a liquidating connotation, it does not carry any implication that the prices used would be those that would be found to exist under panic conditions.

The same financial statements should disclose the shareholders' equity and earnings on a long-term continuing basis. Assets that have been adjusted to market values for the purposes of reporting the amount of equity protecting the depositors should be adjusted to cost for stockholders' purposes if the nature of these assets is such that they will probably be held until maturity and will be worth face value at that time. From the depositors' standpoint it may be desirable to show the market value of the United States Government securities owned, but from the standpoint of the shareholders there is no point in writing down to market a security that may be selling below par at the moment because it carries a low coupon rate. Such a write-down simply transfers income from one accounting period to another.

TAILORING BANKS' ANNUAL REPORTS FOR BOTH DEPOSITORS AND STOCKHOLDERS (II)

(By Henry P. Hill)

It should be possible to devise financial statements that will be useful and informative both to the depositors and their watchdogs and to the shareholders. Such financial statements should clearly indicate the assets available for the protection of the depositors and should state these assets at current realizable values. "Current realizable values," in this sense, means that market values of all assets having a ready market should be disclosed. While it has a liquidating connotation, it does not carry any implication that the prices used would be those that would be found to exist under panic conditions.

The same financial statements should disclose the shareholders' equity and earnings on a long-term continuing basis. Assets that have been adjusted to market values for the purposes of reporting the amount of equity protecting the depositors should be adjusted to cost for stockholders' purposes if the nature of these assets is such that they will probably be held until maturity and will be worth face value at that time. From the depositors' standpoint it may be desirable to show the market value of the U.S. Government securities owned, but from the standpoint of the shareholders there is no point in writing down to market a security that may be selling below par at the moment because it carries a low coupon rate. Such a write-down simply transfers income from one accounting period to another.

STATEMENT OF CONDITION

Exhibit I shows a statement of condition designed to achieve both purposes at the same time. In this statement I have made an attempt to meet the requirements of the two interested groups by segregating the net assets into those primarily available for depositors' claims and those of a capital nature. Another way to think of this separation is to consider as banking assets those assets that will eventually become converted into cash through the banking process and to think of the assets and liabilities that will be consumed, amortized, or otherwise availed of through the income account as equity assets.

Following this concept, the first figure in Exhibit I to be noted is the one described as "excess of banking assets over liabilities to depositors and others." A perusal of this model financial statement will show that this caption shows the amount of the net equity, both realized and unrealized, that is available for the protection of the depositors over and above the face amount of their claims.

For this purpose, Government and municipal securities have been stated at market value regardless of whether this is above or below cost. Cost would be interpreted as amortized cost, both premiums and discounts at acquisition being amortized and, as will be described later, in the case of rollovers or wash sales might be cost of prior issues held. The significance of this concept will be developed later.

Loans and discounts would be stated net of the loan loss reserves allocated to specific loans. In the case of instalment loans it would be acceptable to provide a lump sum reserve to avoid the necessity of providing specific reserves for a large number of loans of small face value. Commercial loans, however, would be evaluated individually and specific reserves set up for those loans that the management thought would be doubtful of collections. The other banking assets would be stated pretty much as they have been in the past, as would the current liabilities.

SHAREHOLDERS' NET ASSETS

The next significant figure in the model statement of financial condition is the total equity of shareholders. This, it will be observed, is arrived at by adding to the assets available for depositors' protection the net undepreciated capital assets, deferred charges and credits to income, and unallocated reserves except those that are really surplus reserves. It is true that in a forced liquidation of a bank the capital assets would produce some funds that could be used to satisfy the depositors' claims. This would not happen, however, as long as the bank was a going concern. On a going concern basis the undepreciated value of capital assets in a statement of financial position is a residual amount showing the portion of the cost that remains to be applied against future earnings.